United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

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IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

JEFF SIMON, as Custodian for GAIL NINA SIMON Under the New York Uniform Gifts to Minors Act,

Plaintiff-Appellant,

vs.

THE NEW HAVEN BOARD & CARTON COMPANY, INCORPORATED, *et al.*,

Defendants-Appellees.

On Appeal from the United States District Court For the District of Connecticut

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PLAINTIFF-APPELLANT'S REPLY BRIEF

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Introductory Statement

Defendants in their brief* contend that Judge Newman found from a review of all the evidence that New

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* All references in this Reply Brief to defendants' brief are to the brief filed by Messrs. Wiggin & Dana on behalf of the defendants other than William Gumbard unless otherwise indicated.

Haven suffered no out-of-pocket damage (p. 5). They argue further that these "findings" established that an "essential * * * element of plaintiff's claim" was "missing", (p. 5) and that, without out-of-pocket damage, New Haven had no right to an accounting for profits or the other equitable relief sought. As shown below, both parts of defendants' argument are without foundation. He found only that one of the claimed non-disclosures caused no damage to New Haven. He failed to make necessary findings under Rule 52(a) as to whether the other thirteen claimed non-disclosures caused such damage and also failed to make necessary findings as to whether the claimed state law breaches of duty of the non-resident directors, including the Simkins, caused such damage (S-1 to S-25).

Moreover, even if Judge Newman had properly found that *none* of the claimed non-disclosures and state law violations caused out-of-pocket damage to New Haven, this would not justify the dismissal of plaintiff's claim for an accounting for profits and other appropriate relief.

Furthermore, defendants nowhere present any authorities for their bare claim that the missing findings as to whether or not the defendants violated 10b-5 or state law were not "necessary" to Judge Newman's decision that the claimed non-disclosure of turnaround and earnings caused no out-of-pocket damage to New Haven. Clearly, even if Judge Newman *had* made findings as to the existence of damage caused by *each* of the claimed non-disclosures, as he did not,—as shown in our main brief (pp. 11-24), such findings as to liability were necessary prerequisites to the dismissal of *all* plaintiff's claims and denial of any relief (S-23).*

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* Defendants admit, in their footnote on p. 5, that "Judge Newman did not make a finding with respect to the alleged violations of state and federal law." They claim that such a finding was not

(Footnote continued on following page)

ARGUMENT

POINT I

Defendants' basic argument that the Court found that none of plaintiff's claimed non-disclosures and claimed state law breaches caused out-of-pocket damage to New Haven is untrue. A reading of the decision shows that Judge Newman found only that one of the claimed non-disclosures did not cause such damage.

As shown below, both parts of defendants' basic syllogism are baseless. *First,* a reading of his decision as a whole (S-1 to S-29) shows that Judge Newman did not find that *none* of the fourteen claimed non-disclosures (reviewed on pp. 2-5 of our main brief) and that *none* of the

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(Footnote continued from preceding page)

necessary to his decision. They cite no decisions supporting their claim in this regard, but simply *assume* that such findings were not "necessary" to the Court's findings and conclusion that the evidence reviewed by it showed no out-of-pocket damage resulting from the claim of non-disclosure of earnings. As shown, *infra,* the missing findings with respect to liability were one of the necessary pre-requisites, even to the restricted findings of no damage made by Judge Newman, under Rule 52(a) and under the procedure mandated by *Mills* v. *Electric Auto-Lite Corp.,* 396 U. S. 375 (1970). Cf. our main brief, pp. 25-28. In fact, *Lewis* v. *Bogin,* 337 F. Supp. 331 and *Dasho* v. *Susquehanna Corp.,* 461 F. 2d 11 (7th Cir.), cited by defendants, clearly support plaintiff's contention that such findings were "necessary" under Rule 52 (a) (i) in order to determine the appropriateness and scope of the damages remedy, based on the fourteen non-disclosure claims which were shown, and also (ii) in order to determine whether or not to weigh the evidence of damage, resulting from *each* proved claim, on the basis of the *Bigelow* principle, shifting the risks of uncertainties as to the quantum of damage to proven wrongdoers.

claimed breaches of fiduciary duty under state law caused out-of-pocket damage, but found only that *one* of the claimed non-disclosures caused no such damage and that the §33-323 state claims *against the resident directors,* based on the same single non-disclosure, caused no such damage. Judge Newman failed to determine whether the evidence presented at the trial showed out-of-pocket damage resulting from any of the *other* thirteen non-disclosures, or whether it showed such damage resulting from any of the state claims against the *non-resident* directors, including the Simkins. *Second,* even if Judge Newman had properly concluded that New Haven suffered no out-of-pocket damages from any of the claimed non-disclosures or state wrongs after having made special factual findings as to each of them pursuant to Rule 52(a), which he failed to do, such proof of damage was not an "essential element" of plaintiff's "derivative action," as claimed on p. 5 of defendants' brief, and would not have eliminated the right of New Haven to an accounting for profits and other equitable relief. Cf. *Ohio Drill & Tool Co.* v. *Johnson* (6th Cir. 1974), *cit. infra,* p. 17.

A reading of the decision, as a whole, demonstrates that defendants' basic premise is mistaken, since Judge Newman found only that the evidence of damage due to the claimed non-disclosure or "omission of the results of an unaudited internal financial report for the company's first quarter * * *" (S-4) was insufficient but made no findings whatever (S-4 to S-22) as to whether the *other* claimed thirteen non-disclosures or omissions (see our main brief pp. 2-5)* or the alleged state law breaches of fiduciary duty (B-5 to B-25) caused damage to New Haven.

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* The documentary evidence of each non-disclosure is detailed in our main brief, pp. 2-5.

At S-4, Judge Newman stated:

> ". . . A principal but *not the only challenged item* is the omission of the results of an unaudited internal financial report for the company's first quarter, ending December 31, 1963, of its 1964 fiscal year. This report, prior to correction, showed first quarter profits of $148,590. Plaintiff's essential contention, in support of which its expert, Dr. Douglas Bellemore, testified at length, is that disclosure of this first-quarter report would have provided a basis on which shareholders could have concluded that the value of New Haven shares at the time of the merger was not $4.50 per share, but $8.62½ per share." (emphasis added)*

Thus, defendants' basic premise that the admittedly-absent findings as to (a) whether the claimed non-disclosures violated 10b-5, (b) whether the defendants violated state law, and (c) whether plaintiff was entitled to an accounting for profits were somehow obviated by comprehensive findings by the District Court that *none* of the claimed items of wrongdoing resulted in out-of-pocket damage to New Haven is not supported by the record. The Court found only that the evidence reviewed by it showed that no out-of-pocket damage resulted from the omission of the current quarterly earnings from the proxy statement. Thus, defendants' basic contention (p. 4) that "Judge Newman *found from the evidence* that New Haven sustained no damage" is not supported by the record.

Judge Newman expressly refused to consider whether the claimed non-disclosures relating to Penn Mutual, Grin-

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* The Court's entire review of the testimony of Dr. Bellemore and the July 1963 block purchases which follows (S-4 to S-22) constitutes the Court's findings as to whether the omission of the quarterly earnings caused out-of-pocket damage to New Haven.

nell and Grand Avenue caused damage to New Haven (S-27, n. 10) because of the erroneous legal assumptions reviewed on pp. 38-39 of our main brief. Judge Newman made no effort, as clearly he was required to do, separately to analyze the evidence of damage attributable to *each* of the claimed non-disclosures and to make separate findings as to *each* area of damage, before concluding that New Haven suffered no out-of-pocket damage and dismissing all the claims for such damage (S-23).

It is clear that Judge Newman failed to make numerous necessary findings mandated by Rule 52(a) and *Mills, supra.*

In addition, as shown in our main brief, the District Court failed to discharge the duties imposed upon it by *Mills* v. *Electric Auto Lite,* 396 U. S. 375 (1970) to scrutinize the evidence as to *each* of the 10b-5 claims in order effectively to "enforce" the securities laws, by furnishing an appropriate remedy for each of the particular wrongs found to have occurred. Appropriateness of remedy can only be determined on the basis of findings containing sufficient detail as to the nature, extent and gravity of each wrong. *Crane* v. *Amer. Standard,* 490 F. 2d 332 (1974). *Electronic Specialty Co.* v. *International Controls Corp.,* 409 F. 2d 937 (2d Cir. 1969), and *Gerstle* v. *Gamble Skogmo, Inc.,* 298 F. Supp. 66 aff'd 478 F. 2d 1281 (1973). Judge Newman was required then to weigh the evidence as to each proven claim on the basis of the *Bigelow* principle,* resolving all uncertainties as to amount against the defendants, as Judge Newman failed to do. (Cf. our main brief pp. 25-29).

Even as to the findings limited to damages due to the non-disclosure of current earnings, which Judge Newman

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* Referring to the decisions cited in Point II(B) of our main brief, p. 25.

did make, he failed to weigh the evidence which he *did* consider (i.e., the Bellemore and Hunt testimony and the July 1963 sales), on the basis of the *Bigelow* principle, i.e., on the assumption that defendants were guilty of such non-disclosure under 10b-5. This legal error tainted these findings which the Court did make, requiring reversal. *Ohio Drill & Tool Co.* v. *Johnson, infra, Bigelow* v. *RKO Radio Pictures,* 327 U. S. 251 (1945); *Story Parchment Co.* v. *Paterson Parchment,* 282 U. S. 555, 563 (1931), *Feit* v. *Leasco Data,* 332 F. Supp. 541 (1971), *Schur* v. *Salzman,* 365 F. Supp. 725 (1974), *Gould* v. *Amer. Hawaiian S. S. Co.,* 362 F. Supp. 771 (1973). Instead he erroneously determined that issue on the assumption that defendants were innocent (S-8, 22, 26, 27).*

Thus, Judge Newman had no right to dismiss on the merits even the single 10b-5 claim which he did consider, since he did not make necessary findings which would support the legal conclusion that, even if defendants were proved to have violated 10b-5 by refusing to share the quarterly earnings with the approving New Haven stockholders,** New Haven, nevertheless, was not entitled to an award for out-of-pocket damages based on the evidence considered by him. In order to support such a legal conclusion, the Court would have had to find (as it did not) that, applying the proper standards of reasonable approxi-

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* Contrast the Court of Appeal's correct analysis of the evidence of damage due to alleged 10b-5 claims, in *Dasho* v. *Susquehanna Corp.,* 461 F. 2d 11 (7th Cir.) cert. denied 408 U.S. 925.

** As he should have held under the principles enunciated in *Republic Technology Fund* v. *The Lionel Corp.,* 483 F. 2d 540 (2d Cir. 1973), based on the fact that the defense of impracticability of disclosure presented at the trial was insufficient, as a matter of law, even if all of the testimony presented by defendants were believed. *Republic Technology, supra.*

mation of damage under the *Bigelow* principle,* and casting the risk of all factual uncertainties as to quantum of damage and causation upon the defendants, the Bellemore testimony and the July 1963 sales were not a sufficient basis for such approximation. *Dasho* v. *Susequehanna Corp., infra.* The decision clearly shows that this was not done and that, if *Bigelow* were applied, New Haven would have been found to have been damaged by this non-disclosure, as plaintiff claimed, because the evidence presented at the trial contained a more than sufficient basis for reasonable approximation of such out-of-pocket damage and disgorgement of the resultant gains to the Simkins.

POINT II

The absence of necessary findings as to the claimed state law violations violates Rule 52(a).

Defendants in their brief (p. 8) admit that no findings were made by Judge Newman as to whether the Simkins were liable under state law for any of the breaches of fiduciary duty realleged in Count II and over which the Court had pendent jurisdiction.**

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* Cf. e.g., the Court of Appeals' review of 10b-5 evidence in *Dasho* v. *Susquehanna Corp.*, 461 F. 2d 11 (7th Cir.) cert. denied 409 U. S. 925 (1972).

** Under 52(a) FRCP, such findings were clearly necessary to the Court's dismissals, *inter alia,* of all of plaintiff's pendent claims under state law against the Simkins for damage and other relief, including accounting for profits for violation of §33-323 and for their breaches of fiduciary duty, quite aside from their violation of §33-323. The District Court had pendent jurisdiction over such claims under COUNT II.

The Absence of All of the Necessary Findings on the State Claims of Breach of Fiduciary Duty under Counts I and II Violates Rule 52(a)—

Moreover, it is clear from Judge Newman's decision that he made no findings whatever as to whether *any* of plaintiff's claims of *breach of fiduciary duty* under state law alleged against all the defendants caused out-of-pocket damage to New Haven, after applying to the evidence the appropriate state burden of proof imposed upon proven wrongdoers* and, insofar as the Simkins were concerned, by applying to them the heavy burdens imposed by Connecticut law on controlling stockholders, who deal with their own corporation.**

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* The Connecticut courts follow the *Bigelow* rule. *Holmes* v. *Freeman,* 185 A. 2nd 88, 23 Conn. Sup. 504, and Connecticut cases cited therein. *Granato* v. *Benettiere,* 246 A. 2nd 901, 5 Conn. Cir. 150, citing with approval *Story Parchment Co.* v. *Paterson Parchment Co.,* 282 U.S. 555.

** Cf. our main brief pp. 29-34. The unsupported claim in the footnote on pp. 8-9 of defendants' brief that §33-323, which deals only with attacks on transactions *merely* because of interest of directors in the transactions, somehow supplanted the Connecticut common law rules governing transactions *involving fraud and breaches of fiduciary duty,* or where the interested directors also *control* the corporation, is without merit. The statute deals with non-fraudulent transactions only, and did not end state common law requirements relating to breaches of fiduciary duty. Cf. *Remillard Brick Co.* v. *Remillard Davidini Co.,* 10 Cal. App. 2d 405 (1952). In any event, the burden under §33-323 to prove "fairness" where proper ratification by the stockholders has not been obtained, relates to the same "fairness" construed in the Connecticut common law decisions, cited in our main brief. Defendants' claim that the text writer in *Cross, Corporation Law in Connecticut,* pp. 296-307 has stated that "cases such as *Cathedral Estates* v. *Taft Realty Corp." supra* * * * "and the other earlier

(Footnote continued on following page)

The Absence of Necessary Findings As to the Resident Directors Violates Rule 52(a)—

As defendants admit in the footnote on p. 9 of their brief, Judge Newman made findings only as to whether *the resident directors* met a statutory "burden" under §33-323 to show "fairness" and that he made no findings that the Simkins, as interested directors, met that statutory burden or met the special common-law burden imposed on them, as controlling stockholders. (cf. the decisions cited in our main brief (p. 31).) He nowhere found whether *any* of the defendants (*including* the resident directors) breached their fiduciary duties, or met the state *Bigelow* burden, which would govern if defendants were found to have breached their fiduciary duties to New Haven, as claimed.* Here, again, Judge Newman's findings to the effect that there was no evidence of damage

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(Footnote continued from preceding page)

Connecticut cases on which plaintiff relies" were supplanted by §33-323 is not supported by a reading of the Cross text. *Cross* correctly recognizes that *Perlman* v. *Feldmann,* 219 F. 2d 173 *Cathedral Estates, supra,* as well as the earlier Connecticut cases cited in our main brief (pp. 30-31). In his discussion of §33-323, *Cross* points out (p. 301 n. 61) that "the 'merely' language (in §33-323) leaves open the possibility of voidability or liability on some other ground", such as fraud or breach of duty, and as to criterion 4 that "*'Fairness'* here is determined in the common law sense," referring to *§33-323(a)3.* Thus *Cross* agrees with each of plaintiff's contentions in this regard.

* The detailed review of the evidence of these breaches of fiduciary duty is set forth in plaintiff's post trial brief (Doc. No. 19) encompassing the improper domination by the Simkins of the board, the rubber-stamping of the ratio by the purportedly "independent" board, without having before it the final appraisal of A.A.C., the deliberate delay in disclosing news favorable to New Haven until after the merger so the Simkins could profit at New Haven's expense, the repeated material fourteen inter-connected misrepresentations and non-disclosures appearing on almost every page of the proxy statement, etc., etc. (Doc. No. 19).

due to the state wrongs were limited to damage resulting from non-compliance by the resident directors with §33-323, and not from their breaches of fiduciary duty alleged in Counts I and II and were further limited, as shown in Point I, *supra,* to such damages resulting from non-disclosure of one of the fourteen factors alleged to have been withheld by the directors from the proxy statement. They did not extend to damage due to the claimed breaches of duty by either the resident directors or by the non-resident directors alleged in Counts I and II. Thus, it is plain that Judge Newman found, as to the state claims, that only the claim of non-disclosure of earnings by the resident directors did not result in out-of-pocket damages to New Haven recoverable under §33-323, but failed to make any of the other findings as to the resident directors or the Simkins, which would be necessary to his determination of *all* the state claims alleged in Count I and incorporated by reference into Count II (B-24, B-25), even if all other necessary and appropriate factual findings had also been made as to the state claims, as clearly they were not, for the reasons stated above.

The Total Failure to Make Any Findings on Liability *Or* Damages As to the State Claims Against The Simkins Violates Rule 52(a)—

On p. 8 of their brief, defendants ignore the fact that the District Court had pendent jurisdiction over *all* of the defendants under Count II (which incorporated the facts alleged in Count I of breach of fiduciary duty) to grant relief under state law based on the same facts and transactions as are alleged as violations of 10b-5. *United Mine Workers of America* v. *Gibbs,* 388 U.S. 715 (1966).

Although the Simkins on May 21, 1965, upon the ground of improper venue, were able to avoid the Court obtaining diversity jurisdiction over them because they were

not Connecticut residents (A-2), Judge Zampano granted plaintiff leave to file an amended complaint (A-3). On September 29, 1965, plaintiff's cross-motion to add the Simkins, among others, as party defendants to Count II of the Amended Complaint was granted. On October 21, 1965, the Second Amended Verified Complaint was filed, and on October 22, 1965, the Simkins appeared through their attorneys (A-4). On March 4, 1966, the Simkins filed their Answer to the Second Verified Complaint (A-4), giving the District Court both federal and pendent jurisdiction to dispose of all federal and state claims included within Count II. Judge Newman, having found the Simkins to have been controlling stockholders of New Haven at the time of the merger (S-2), erred, as a matter of law, in failing affirmatively to impose upon the Simkins the heavy burden of proof imposed by Connecticut law, in such circumstances, on the issues of fact of damage, quantum of damage and liability to account for profits, gains and benefits.*

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*Cf. POINT II(C) and POINT III of plaintiff's main brief (pp. 29-32). It is noteworthy that the Court's finding that the Simkins were actually in control of New Haven also proved the element of falsity of one of the claimed violations of 10b-5 and the Simkins state law duties of honest dealing. The disclosures in the proxy statement (A-15) were inadequate to inform the stockholders that the allegedly "independent" board which purportedly reviewed the ratio at arm's length, approved it and was recommending it to the stockholders (S-5), was in fact under the domination and control of the Simkins (S-2). Cf. *Mills* v. *Electric Auto Lite, supra, Mader* v. *Armel* (D. Ohio) '70-71' CCH Fed. Sec. L. Rep. ¶93027, p. 90795, aff'd 461 F. 2d 1123 (CA-6 1972). Judge Newman's decision is bare of any findings on this claimed violation or as to whether, viewed either alone or in conjunction with any of the other thirteen violations, it caused damage to New Haven, or whether such a violation had any other appropriate remedy. Cf. *Mills, supra,* concerning the numerous factors which the Supreme Court required be considered, before disposing of a virtually-identical 10b-5 violation and the matter of an appropriate remedy for such violation.

Judge Newman also erred, as a matter of law, in failing to find and determine whether or not the Simkins, as controlling stockholders, chief executive officers, and directors, violated any of their Connecticut duties of the highest good faith, fair dealing, and full disclosure, before disposing of plaintiff's state claims. If such findings had been made in plaintiff's favor, as they should have been, based on all of the extensive documentary and undisputed evidence of the most deliberate and willful kind of pervasive, repeated fraud and overreaching,* *all* of the evidence of damage presented in the documents and testimony at the trial [including but not limited to (1) the expert testimony, (2) the prior comparable block sales in July 1963; and (3) the documentary evidence showing non-inclusion of $2.055 per share for the Penn Mutual, Grinnell, and Grand Avenue values, a control premium and the value of the tax loss carryforward in the $4.50 merger price] would then have to be evaluated by Judge Newman on the basis of the state rules, shifting the burden to the Simkins on the numerous, complex issues projected as to the approximate damage caused by each claimed non-disclosure and each breach of duty in corrupting the corporate process and in fraudulently manipulating inside information, for the exclusive benefit of the Simkins. Since the Bellemore testimony and the other evidence reviewed as to the non-disclosure of earnings were also evidence of damage due to the Simkins' alleged breach of trust, the same state burden was required to be applied to them and was not. Similarly, the affirmative specific factual burdens imposed on them by *Cathedral Estates* and *Perlman* v. *Feldmann, supra* clearly were not considered in evaluating Prof. Hunt's testimony which clearly failed to meet the state law requirements.**

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* Cf. our main brief, pp. 6-8 and Doc. No. 19, our post-trial brief.

** Cf. POINTS II(c) and III of our main brief.

Indeed, a careful review of *each* of the Court's erroneously-restricted findings limited to damage resulting from the non-disclosure of earnings shows that Judge Newman erroneously placed the full burden on the plaintiff to show not only the fact of damage but also the precise amount of damage. Since the principles enunciated in *Bigelow, Cathedral Estates* and *Perlman* had to be applied to the evidence of that non-disclosure, as clearly they were not, the Simkins had the burden to prove "fairness" *in all respects* by their testimony and that of Prof. Hunt, not merely "fairness" in the sense of adequacy of consideration.*

Under Connecticut law, the burden to show "fairness" includes candor and honesty "in all its aspects". *Cathedral Estates, supra* 228 F.2d at 87. (See as to §33-323: *Cross, Corporation Law in Conn.* p. 306). It encompasses the burden of proof on all of the issues relating to the alleged non-disclosure and damage projected at the trial as well as at the accounting for profits sought by plaintiff. Defendants would also have the burden on *each* of the factual issues projected at the trial relating to inadequate or improper disclosures by the Simkins to the board of directors, their improper domination of the board

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* Judge Newman actually applied only the erroneously-limited burden, which he concluded was imposed by Sec. 33-323 of the statute *on the resident directors,* as to the evidence presented relating to the damage due to claim of non-disclosure of earnings. Thus, even as to these erroneously-limited findings, he misconstrued the state burden to establish "fairness" to relate only to fairness in the sense of adequacy of consideration. Here, again, he erred further as to the requisite standard of proof as to "adequacy of consideration" by accepting anything less than affirmative proof of the "fair market value" of the disputed block, as required by the decision of this Court in *Cathedral Estates, supra,* and by Chief Judge Smith (*Cathedral Estates* (D.C. Conn.) 157 F. Supp. 895, 902) and by the decision of this Court in *Perlman* v. *Feldmann,* 219 F. 2d 173 (2d Cir.)

in obtaining its approval and the deliberately delayed disclosures of the turnaround, the Penn Mutual, Grand Avenue profits and the tax loss benefits until *after* the merger, etc., etc.

Defendants also had the burden affirmatively to prove the "fair market value" of the New Haven block, without control premium. *Perlman, supra, Cathedral Estates, Inc., supra.* They also had the burden of proof on all factual issues pertaining to both the *fact* and *amount* of damage, to show that New Haven was not damaged "in any way" by the wrongs shown. *Perlman* and *Cathedral Estates, supra.*

The burden to show fairness also imposed on the Simkins the burden on *all* of the separate factual issues relating to fairness of disclosure and damage arising *from* the non-disclosure relating to turnaround, the quarterly-earnings of New Haven, the factors pertaining to control premium (found by Judge Newman to be due to New Haven upon the merger *without* determining the exact amount (S-18)), the $2,000,000 tax loss carryforward, etc.

Thus, in *Pappas* v. *Moss,* 393 F. 2d 865 (1968), the burden that the District Court failed to place on the defendants under state law to prove fairness in all respects was held to encompass the duty to prove that the $6 merger price was "honest". On remand, the District Court held that the price was not "honest" because of their "failure to reveal the turnaround and allow the stock market time to react to it, prior to their entering into the transactions in question." The Simkins committed the same type of fraud as to *all* of the non-disclosures. On the legally unacceptable pretense that they somehow could not disclose the quarterly earnings, with appropriate qualifications, they dictated a $4.50 merger price, based on a corporate picture falsely portrayed as without any profitable future when they knew, at the least, that a turnaround or im-

proved earnings were imminent.* Cf. *Republic Technology, supra.*

Clearly, therefore, not only did the District Court err in concluding that the resident defendants met a statutory burden to show "fairness" of the $4.50 price, but also in failing to determine whether or not the Simkins met *any* of the burdens imposed upon them by State law. The Court's dismissal of *all* of plaintiff's state claims clearly was tainted by the numerous legal errors referred to above, and by the Court's total failure to comply with Rule 52(a) as to the dismissal of the State claims against the Simkins.

POINT III

Defendants' contention that the exclusive remedy in a derivative 10(b) 5 action is out-of-pocket damages is without merit.

Judge Newman also failed to make necessary findings and conclusions under Rule 52(a) and the *Mills* decision as whether any of the claimed violations of state and federal law gave New Haven the right to obtain a full accounting from the defendants for all the profit, gains and benefits resulting from each of such violations, as distinct from out-of-pocket damages.

Judge Newman also made no findings as to whether, aside from damages or profits, the proved violations might be remedied and the defendants' duties effectively "en-

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* Their failure to reveal the true facts as to the valuable tax loss carryforward, the Grinnell holdings of New Haven, the profits in the Grand Avenue and Penn Mutual transactions are of the same species of fraud and cry out for an appropriate remedy and disgorgement of their disproportionate share in the benefits.

forced" under federal and state law, by other appropriate relief in equity, such as an injunction against future violations, declaratory relief, with the attendant benefits discussed in *Mills* v. *Electric Auto Lite,* 396 U.S. 375, or such other relief, as Judge Newman might be required to fashion to remedy the particular wrongs found by him to have occurred, as required by a proper discharge of the special enforcement duties imposed on District Courts in cases of this type, *Mills, supra.*

Defendants err in contending (p. 7) that the necessity for such findings as to *other* remedies, including the claimed accounting, was somehow obviated by Judge Newman's limited, erroneous findings that New Haven suffered no damage as a result of plaintiff's claim of non-disclosure of earnings. It is clear that even if Judge Newman's findings had correctly determined there was no evidence of out-of-pocket losses to New Haven or due to *any* of the fourteen claimed non-disclosures or due to *any* of the pendent claims of violation of state law, as clearly they did not, such finding of no out-of-pocket losses to New Haven would not bar an accounting by the Simkins and their co-defendants for all profits, gains and benefits resulting from any of the alleged wrongs. In *Ohio Drill & Tool Co.* v. *Johnson* (6th Cir. 1974), CCH Fed. Sec. L. Rep. para. 94,596, the Court of Appeals in reversing *Ohio Drill & Tool Co.* v. *Johnson,* 361 F. Supp. 255 (S.D. Ohio 1973),* rejected the principal argument which defendants make in their brief, by holding (at pp. 96,099-96,100):

> "The plaintiffs, seeking disgorgement of the profits made by the defendants on the Fortune transac-

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* The reversed decision is cited on p. 7 of defendants' brief. They neglect however, to point out that the decision relied upon was reversed on June 12, 1974 upon the point for which they cite it.

tions under Rule 10b-5 liability, urge that the district court applied the wrong standard of damages in denying recovery. *The district court held that the measure of damages in a stockholders' derivative action is limited to out-of-pocket losses suffered by the corporation.* Since Fidelity actually made a profit on the venture there was, according to the District Court, no damage. We disagree.

"The proper standard of damages for either a defrauded seller or buyer under Rule 10b-5 is 'disgorgement of profits.' In *Janigan* v. *Taylor,* 334 F. 2d 781 (1st Cir.), cert. den. 392 U.S. 879 (1965), a seller's action under Rule 10b-5 to recover the buyer's profits, the court awarded the defrauded party the benefit of the defendant's bargain. The court stated:

> '(T)here can be no speculation but that the defendant actually made the profit and, once it is found that he acquired the property by fraud, that the profit was the proximate consequence of the fraud, whether foreseeable or not. It is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them . . . (I)t is simple equity that a wrongdoers should disgorge his fraudulent enrichment.

"Both *Janigan* and a similar case, *Myzel* v. *Fields,* 386 F. 2d 718 (8th Cir. 1967), cert. den. 390 U.S. 951 (1968), were cited with approval by the Supreme Court in *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128 (1972). Although *Janigan* was concerned with the disgorgement of profits remedy to the defrauded sellers, a recent Second Circuit case, *Zeller* v. *Bogue Electric Mfg. Corp.,* 476 F.

2d 795 (2d Cir. 1973), extended the disgorgement remedy to defrauded buyers. In so doing, the court stated:

> "We do not consider the cited cases, or our own decision in *Levine* v. *Seilon, Inc.*, supra, 439 F. 2d at 334, as having established any such bright line between defrauded sellers and defrauded buyers as defendants urge . . . The reason why the remedy has been applied for the benefit of defrauded sellers but not of buyers is not any decisive legal difference but the difficulty generally confronting the defrauded buyer in showing that the fraudulent seller has in fact reaped such a profit. Id. at 801-802.
>
> "*The district court made no specific findings as to fraud in the Fortune transaction, laboring under a misapprehension with respect to the proper standard of damages.* Its error in its determination as to the law on this issue, tainted its findings of fact. In consequence, the action must be remanded for a determination as to whether there was a Rule 10b-5 fraud in the Fortune National transactions. *If such fraud is found, then the court must reconsider the question of damages in light of this opinion.*" (Emphasis added)*

We submit that a proper measure of the accounting for profits, gains and benefits upon remand resulting from

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* The above-quoted decision also furnishes further support for plaintiff's contentions that Judge Newman's failure to make specific findings as to each of the fourteen claimed items of fraudulent violations of 10b-5, the numerous breaches of duty, and other specific violations of 10b-5 enumerated in plaintiff's post trial brief (Doc. 19) tainted its limited findings on damages. See: *Crane Co.* v. *Amer. Standard Inc.*, 490 F. 2d 232 (2d Cir. 1974) and our main brief pp. 11-35.

each of the fourteen claimed non-disclosures and state wrongs, among others, would be for the Court or Special Master reasonably to approximate the amount of profit resulting from each of the non-disclosures on the basis of the basic test used in *Gerstle* v. *Gamble Skogmo,* 478 F. 2d 1281 (2d Cir. 1973) and *Gould* v. *American Hawaiian S.S. Co., supra,* to wit, that the defendants shall account to the corporation for all of the profits, gains and benefits measured by the deprivation of the opportunity of New Haven through its stockholders to obtain a price *higher than* the $4.50 price assigned to the disclosed value by the Simkins for *each* omitted item of value. For example, if this Court should determine that the Simkins violated 10b-5 by concealing the facts pertaining to New Haven's right to a control premium, then this Court should order that the Simkins must disgorge the value of the control premium as part of their secret profits and gains.

Similarly, if this Court determines that defendants violated 10b-5 by not disclosing facts which would enable New Haven, through its stockholders to bargain for and obtain an additional amount per share for the value of the concealed $2,000,000. tax loss carryforward, it should order an accounting for the profits obtained by the Simkins under an appropriate measure at the accounting, to be determined by this Court or by the District Court.* The same holds true for any profits accruing to the Sim-

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* One such appropriate measure at the accounting sought would be the Simkin's disproportionate share of this benefit received by their fraud, i.e., 83.9% of the actual tax savings achieved by New Haven post-merger by use of the concealed tax loss carryforward, less their legitimate share of those tax savings which they would have obtained if no merger had been attained through their fraud. Since this item of value was not disclosed in the proxy statement, it was not included within the $4.50 merger price and the Simkins profited by never paying for this valuable item.

kins from any of the other 10b-5 and state law violations which plaintiff seeks to have this Court find in its favor, including the profits resulting from the non-disclosures relating to the Penn Mutual, Grand Avenue and Grinnell matters, etc. Thus, the defendants are clearly accountable for the $2.055 per share in additional values resulting therefrom as ill-gotten gains because those values were not included in the $4.50 merger price assigned by the Simkins to the disclosed values and, therefore, New Haven was never paid for them.

Defendants have misconstrued Judge Newman's decision. It is clear from a reading of the decision that among other things:

(A) Judge Newman erroneously concluded, as did the District Court in *Ohio Drill & Tool supra*, that the measure of damages in a derivative 10b-5 suit was limited to out-of-pocket losses measurable as of the date of merger and did not extend to profits, gains and benefits accruing to the wrongdoers at the time of merger or post-merger. This error was caused by his erroneous legal conclusion that this was established as the "law of the case" by the prior Zampano decision. (S-6, Cf. our main brief, p. 18.)

(B) He erroneously failed to find from the evidence whether or not any of the 10b-5 claims of non-disclosure other than the claim of non-disclosure of current earnings on the pendent state claims against the Simkins caused out-of-pocket losses to New Haven. Such findings were necessary under Rule 52(a) and *Mills*.

(C) He erroneously failed to find, pursuant to the Court's pendent jurisdiction under Count II, whether the Simkins bore their burdens under Sec. 33-323 of the Connecticut Corporation Law and under the principles enunciated by this Court in *Taft Realty* and *Perlman* v. *Feldmann, supra,* to show (1) fairness and honesty in all re-

spects, (2) that New Haven suffered *no* damage from *any* of the wrongs and non-disclosures charged, and (3) that defendants made *no* secret profit, gain, or benefit as a result of any of such non-disclosures or from any of the breaches of duty, reviewed in the plaintiff's post-trial brief, including their manipulation of the good news about New Haven available to them so as to prevent the OTC market prices from reflecting the concealed values, and improperly causing the purportedly "independent" board of directors to approve the merger to furnish window dressing for the deceptive proxy which followed.

(D) As to the findings which the Court did make, to wit, that New Haven suffered no out-of-pocket damage from the claimed non-disclosure of current earnings, Judge Newman erred in failing first to determine whether any of the defendants violated 10b-5 by means of such non-disclosure and then to weigh the Bellemore testimony and the evidence relating to prior sales in July 1963 on the basis of the *Bigelow* principle. These limited findings must be reversed.

(E) Judge Newman erred generally in failing first to determine which of the alleged wrongs occurred so as properly to fashion appropriate remedies for each of the wrongs proved as required by the equitable principles established in *Mills*.

Such remedies should include a full accounting for *all* damages and profits resulting from all of the alleged non-disclosures as well as declaratory relief prior to the accounting and an interim allowance for counsel fees as required by *Mills*.

At the very least, *Mills* requires a finding and declaration that 10b-5 has been violated, even before monetary relief is determined, and an interim award for counsel

fees be granted for obtaining such declaration for the benefit of the corporation. The decisions cited by defendants in their Point II (pp. 15-26) do not interpret *Mills* to hold to the contrary.

Each of the decisions cited by defendants support plaintiff's contentions on this appeal. *Lewis* v. *Bogin*, 337 F. Supp. 331 (1972) is distinguishable. There, the trier of fact had held that the merger price of $18.50 was correct and no damage was shown because it was found to have *"taken into account all factors which plaintiff claim(ed) were omitted from the proxy statement."* (p. 337 emphasis in original). Here, no such finding was made below and the evidence demonstrated that the $4.50 merger price did not take into account all the "factors omitted from the proxy statement," i.e., the turnaround, the $2.055 in concealed profits and assets, the value of the tax loss carryforward and the control premium and that, therefore, New Haven was damaged and defendants profited by their fraud. In *Dasho* v. *Susquehanna Corp.*, 461 F.2d 11 (7th Cir.) the Circuit Court determined whether the evidence presented showed damage on the basis of the *Bigelow* principle of reasonable approximation, a test which Judge Newman failed to employ. *Swanson* v. *American Consumers Industries*, 475 F.2d 576 (7th Cir. 1973) is distinguishable because there the District Court made complete particularized factual findings as to each of the damage factors, as was not the case here. Both *Swanson* and *Dasho* hold that the finding of 10b-5 violation requires a finding of "legal injury" (defendants' brief p. 23), that monetary damages are not established by the fact of injury but that such must be determined by the *Bigelow* rule. None of the three decisions even deal with the issue as to whether a finding of legal injury and 10b-5 violation entitles a plaintiff to obtain an interim award for counsel fees even if no damage or profit is ultimately granted at an accounting; much less do they "interpret" *Mills* to the contrary, as incorrectly claimed by defendants on p. 15 of their brief.

CONCLUSION

Since the evidence of defendants' violations of 10b-5 and state law is documentary and non-demeanor in nature, and the instant action has been pending for many years, the interests of justice shall be served if this Court should make findings and conclusions as to each of the fourteen 10b-5 non-disclosures charged (Cf. our main brief pp. 2-7) and as to each of the breaches of fiduciary duty and violations of Sec. 33-323 charged. The decision should be reversed and the relief requested on pp. 42-43 of our main brief should be granted with costs.

Respectfully submitted,

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Dated: July 19, 1974

Of Counsel:

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376—Affidavit of Service by Mail The Reporter Co., Inc., 11 Park Place, New York, N. Y. 10007

Jeff Simon

vs.

The New Haven Board and Carton Co. Inc.

State of New York, County of New York, ss.:

Harold Dudash, being duly sworn deposes and says that he is agent for Bobroff, Olonoff & scharf the attorney for the above named Appellant herein. That he is over 21 years of age, is not a party to the action and resides at 2530 Young Ave, Bronx, N.y.

That on the 19th day of July, 1974, he served the within

Plaintiffs-Appellants Reply Brief

upon the attorneys for the parties and at the addresses as specified below

Wiggin & Dana, Esqs.
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New Haven, Ct. 06508

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by depositing three true copies to each of the same securely enclosed in a post-paid wrapper in the Post Office regularly maintained by the United States Government at 90 Church Street, New York, New York directed to the said attorneys for the parties as listed above at the addresses aforementioned, that being the addresses within the state designated by them for that purpose, or the places where they then kept offices between which places there then was and now is a regular communication by mail.

Sworn to before me, this 19th day of July, 1974

Roland W. Johnson

ROLAND W. JOHNSON
Notary Public, State of New York
No. 4609705
Qualified in Delaware County
Commission Expires March 30, 1975

H. G. Dudash